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SUMMARY of COOPERATIVE CASES

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> The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

IRS RULING ON TREATMENT TO BE ACCORDED GRAIN HANDLING AND STORAGE CHARGES BY TAXABLE COOPERATIVES.

(Rev. Rul. 59-107; I.R.B. 1959-14, p. 7)

When, as part of the price support program, money is loaned to a farmer-producer on his warehouse receipt for grain stored in a nonexempt cooperative, storage charges paid by the Commodity Credit Corporation for the period prior to default are income allocable to members as patronage dividends and are excludable from the cooperative's income if there was a preexisting obligation to allocate such patronage income.

The storage charges paid by the Commodity Credit Corporation for the period following default constitutes income not derived from patronage, as the grain at that time belongs to the Commodity Credit Corporation. A nonexempt cooperative for taxable years beginning after December 31, 1951, is taxable on such income whether or not it is allocated to patrons.

In either case, allocations to the patron are taxable income to the patron.

Advice has been requested with respect to the Federal income tax treatment to be accorded the handling and storage charges applicable to the first year's storage of grain delivered to a taxable cooperative by a member (farmer-producer) who has received a Commodity Credit Corporation loan.

By legislation, the United States Government makes or insures loans to farmer-producers as part of the price support program. Since these loans are made without recourse to the farmer, the lender looks to the pledged commodity as the sole collateral for the satisfaction of the loan in case of default by the farmer. During the period of the loan, the farmer stores the pledged commodity. Sometimes he pays the storage in advance, but more often he does not.

If the farmer wishes a price-support loan with respect to a crop, he usually delivers the grain in July or August of the given crop year. When the grain is delivered to the taxable cooperative, the farmer obtains a negotiable warehouse receipt for the amount of

grain delivered. This receipt shows whether or not the storage charges have been prepaid. The farmer-producer may obtain his loan from a local lending agency approved by the Commodity Credit Corporation. The corporation agrees to purchase on demand any note in approved form from the lending agency from which the producer has obtained a loan, if the note is presented within the specified time of redemption. Storage and handling charges to the date of maturity are deducted from the proceeds of the loan unless such charges have been paid or prepaid by the farmer. In a large percentage of the cases, the Commodity Credit Corporation has to take title to the grain. It pays the lending agency for the note and pays all storage and handling charges on the grain covered by the note.

Some of the cooperatives are of the opinion that the portion of the Commodity Credit Corporation payment received by them which is attributable to storage and handling of a member's grain for the period before the take-over date (usually March 31) should be treated as business done with the member and that the resulting income should be treated as patronage income subject to allocation to the member. On the other hand, some cooperatives are of the opinion that the Commodity Credit Corporation payment received by them which is attributable to storage and handling of a member's grain for both the period before and the period after the take-over date should be treated as business done with the member and the resulting income for both periods should be treated as patronage income subject to allocation to the member. The pertinent part of Senate Report No. 781, C.B. 1951-2, 458, at 472, relating to amendments by the Revenue Act of 1951 to section 101 (12) of the Internal Revenue Code of 1939 with respect to farmers' cooperatives, states that "nonoperating income such as interest, dividends, rents, and capital gains and also the income from certain business done with the United States Government or its agencies, is taxable to the ordinary cooperative even when allocated to the accounts of patrons * * *." The above-quoted language indicates that Congress intended income from business transactions with a governmental agency like Commodity Credit Corporation to be taxable to a nonexempt cooperative whether or not such income is allocated to the accounts of patrons.

Under the pertinent provisions of the Revenue Act of 1951, continued under section 521 and section 522 of the Internal Revenue Code of 1954, tax-exempt farmers' cooperatives are taxable substantially to the same extent as non-exempt farmers' cooperatives. The only distinction between tax exempt and the nonexempt cooperatives

is that exempt cooperatives are allowed a statutory deduction for their limited dividends on capital stock and for allocations of incidental nonpatronage receipts to patrons on a patronage basis.

Generally, storage and handling charges to the date of maturity or default are deducted from the proceeds of the loan unless they have been prepaid by the farmer-producer. The Commodity Credit Corporation takes title upon default and payments for the period after default are made on its own account.

A pre-existing obligation to allocate patronage dividends, rebates, or refunds to a member is necessary before a cooperative can exclude such amounts from its taxable income. The following statement regarding the exclusion of patronage dividends from the Federal income tax of a nonexempt cooperative appears in Farmers Cooperative Company v. Birmingham, 86 Fed. Supp. 201, at 213:

> "* * * The exclusion of patronage dividends for federal income tax purposes has not been placed upon the ground that cooperatives are special creatures of statutes under the tax laws, but justified rather upon the theory that patronage dividends are in reality rebates on purchases or deferred payments on sales, allocated or distributed pursuant to a pre-existing obligation of the cooperative, and thus do not constitute taxable income to the cooperative. * * * "

A cooperative may allocate to its patrons on the basis of business done with such patrons margin which otherwise would be its own income and its income may be reduced to the extent of the allocation on the theory that the amounts allocated were not income to the cooperative. The fact that the exclusion is allowable if it is made pursuant to a pre-existing obligation is emphasized in Revenue Ruling 54-10, C.B. 1954-1, 24, 25.

Accordingly, it is held that when, as part of the price support program, money is loaned to a farmer-producer on his warehouse receipt for grain stored in a nonexempt cooperative, storage charges paid by the Commodity Credit Corporation for the period prior to default are income allocable to members as patronage dividends and are excludable from the cooperative's income if there was a pre-existing obligation to allocate such patronage income.

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STATE ANTITRUST INVESTIGATION; MOTION TO QUASH ATTORNEY GENERAL'S SUBPOENA *DUCES TECUM* DENIED

(*Syracuse Cooperative Milk Distributors' Bargaining Agency, Inc., v. Attorney General of the State cf New York*, 177 N.Y. S.2d 107 (1958))

This was a proceeding on a motion of a cooperative milk distributors' bargaining agency to quash the Attorney General's subpoena *duces tecum* in connection with an investigation under a statute empowering the Attorney General to investigate monopolies and arrangements in restraint of trade. The Supreme Court held that the movant's evidence was insufficient to show the immateriality of the records sought, and denied the motion.

A subpoena *duces tecum* had been served upon Syracuse Cooperative Milk Distributors' Bargaining Agency, Inc., by the Attorney General of the State of New York requiring it to produce all its books and records. In opposition to petitioner's motion the Attorney General made more definite the purpose of the investigation being conducted by him by stating that he was seeking information "concerning anti-competitive activities in connection with the production, handling, sale and distribution of milk and milk products in and about the City of Syracuse."

The bargaining agency attacked the subpoena on two grounds:

(1) The Attorney General had not stated his purpose with sufficient particularity to permit a determination of the relevancy of the material demanded; and

(2) The material sought would be immaterial because the agency was exempt from the anti-monopoly restrictions of the Donnelly Act (General Business Law §§340-347).

The Court rejected both objections. On the first, it held that any deficiency in the subpoena was cured by the affidavit filed in this proceeding.

On the second point, the Court said that petitioner was clearly and apparently exclusively engaged in activities connected with the milk industry and, accordingly, "the records sought will in all probability be directly relevant to the matters under examination." Moreover, a subpoena may validly be issued to strangers as well as parties to a controversy, and therefore, the fact that the agency may be immune from prosecution by the State does not invalidate the subpoena.

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CONTRACTS; VOID AS BEING AGAINST PUBLIC POLICY; DIVISION OF TERRITORIES BY ELECTRIC COMPANIES

(Montana-Dakota Utilities Co. v. Williams Electric Cooperatives, Inc. C.C.A. 8th, 263 F. 2d 431 (1959)).

A REA cooperative's exclusive service contract, whereby it had divided the territory to be served between itself and another electric public utility company is void as being against public policy, according to the United States Court of Appeals, Eighth Circuit. A lower court judgment for damages for breach of this contract was reversed on appeal.

The contract in question was entered into on July 21, 1952, by the Williams Electric Cooperative, Inc. (hereinafter called "the Cooperative") and the Montana-Dakota Utilities Company (hereinafter called "the Company"). Each agreed to respect the area designated to the other as indicated on a map representing the Williston community and surrounding area; and each agreed that it would not solicit customers in the other's territory for electric service. However, subsequently, upon formal consumer request to do so, the Company extended its facilities to three electric consumers located in the area designated by the contract as being in the Cooperative's territory. The Cooperative filed a complaint before the Public Service Commission of North Dakota requesting issuance of an order restraining the Company from serving present and prospective customers in the prohibited area. The Cooperative, in support of its complaint before the Commission relied on the contract in question and on the charge that the Company was acting within the disputed area without authority of a certificate of public convenience and necessity, as required by the North Dakota law.

The Commission dismissed the complaint and this action was subsequently affirmed in all respects by the Supreme Court of North Dakota, which ruled that the extensions of service by the Company, although made without a certificate of public necessity, were lawful within the exceptions of Paragraph 3 of § 49-0301, N.D.R.C. 1943, 1953, Supp., which allows extensions without certificates, " * * * into territory contiguous to that already occupied by it and not receiving similar service from another utility, or electric cooperative * * * or if no certificate of public convenience and necessity has been issued to any other public utility."

Being unsuccessful in its efforts to force the Company to discontinue furnishing electric service in its claimed territory, the Cooperative instituted an action for damages. The Company contended that since the contract had for its principal object the dividing of trade territory between parties affected with a public interest, it was contrary to public policy, and therefore, was void and unenforceable. The court adopted this view. It pointed out that, by the great weight of authority in this country, the rule has been promulgated and consistently applied that contracts between quasi-public corporations, having for their object the division of territory between such companies, are against public policy and are absolutely void, untempered by any application of the "rule of reason" relied on by the Cooperative. The principle

is that such corporations shall not bind themselves by contract not to serve the public interest as the demand arises. To say that the Company was not bound to extend its lines to serve the public convenience is one thing, but to say that it shall not do so, because of the binding force of its contract with an individual or corporation, is quite another, and very different thing.

The court concluded that the contract involved here was such that, not only would it be denied specific enforcement, but, being void, it also could not support an action and judgment for damages.

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MASTER AND SERVANT - COOPERATIVE HELD LIABLE FOR LOSS CAUSED BY FRAUD OF ITS AGENT.

(Thrower v. Coble Dairy Products Cooperative, Inc., ___ N.C. ___, 105 S. E. 2d 428 (1958)).

This was a civil action brought to recover $21,200.00 which the plaintiff alleged the defendant through its agent and servant, Raymond Queen, had obtained by false pretenses from the plaintiff. The plaintiff's evidence tended to show that during the time involved the plaintiff operated a grocery store and market in the Town of Belmont, North Carolina. From August 1953 to February 1956 the plaintiff purchased milk and dairy products from the defendant on open account. In these transactions Raymond Queen was agent and employee of the defendant except for five months beginning April 21, 1954. In this capacity he manipulated the carbon copies of the delivery vouchers in such a way as to obtain the signature of the plaintiff thereon, as well as on the original, and then inserted different amounts on the carbon copies, from which collections were made. The court found the plaintiff had paid $15,579.25 for milk products not delivered. The lower court, therefore, entered judgment in that amount and the defendant appealed.

The appellate court concluded that the evidence showed that fraud was committed in the sale of defendant's products and in the padding of accounts its agent was authorized to collect. The court held, also, that the fact that plaintiff apparently trusted defendant's agent would not preclude recovery. Therefore, the defendant cooperative, as the employee's principal, was held liable for plaintiff's loss and the lower court judgment was affirmed.

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SALES; TORT LIABILITY OF VENDOR

(Doane v. Farmers Cooperative Company, 94 N.W. 2d 115, 1959)).

A cooperative is liable for damages to a farmer's cattle resulting from the sale of corn to the farmer which had become poisoned by reason of applied weevil killer.

The plaintiff was a farmer and cattle feeder who in the fall of 1955 was feeding 177 head of cattle. On December 5 of that year he received a call from defendant elevator, advising him that they had some damaged corn for cattle feed if he was interested in it. He obtained the corn and in course of time fed some of it to 137 head of cattle. Late in the day of December 7, he discovered that one of his cattle was dead and the rest were "off feed." He then quit feeding the damaged corn but in the course of two or three days 21 head of cattle had died and the rest of the 137 were sick. He had not fed any of the damaged corn to the 40 cattle in another lot, and none of them were sick. On December 8 he went to the elevator and reported the situation. The manager assured him that the Board would no doubt treat him right.

The veterinarian whom the defendant had called diagnosed the cause of death to the cattle and of those which were sick as poisoning. Plaintiff sued for $3,780.00 for the 21 head of

cattle that died and damage sustained by reason of sickness of the remainder of the herd. The jury returned a verdict of $1,365.00 in favor of the plaintiff, and defendant appealed, alleging that there was too much speculation as to reason for the damage and requesting withdrawal from the jury of all reference to "914 Weevil Killer" with which its manager had testified the corn had been sprayed in September before it was purchased by plaintiff and fed to his cattle in December.

The court held that there were sufficient circumstances shown by plaintiff that the jury was entitled to pass on the evidence of the two parties, pro and con, and decide the question of fact involved as to the cause of sickness and death of plaintiff's cattle. The admission of opinion evidence rested largely in the sound discretion of the court. The trial court did not commit error in submitting the evidence as to the weevil killer, under the proper precautionary instructions which were given by the court. The fundamental principle of damage is to restore the injured party to the original position occupied by such party prior to the tort, either through restoration of property, if possible, or through measurement of the damage in money value.

The court held that the case was properly submitted to the jury under comprehensive and fair instructions and the lower court decision was affirmed.

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MOTOR CARRIERS - TRUCK TRACTOR OWNER-OPERATORS CANNOT BE USED UNDER EQUIPMENT LEASE WITHOUT CONTRACT - CARRIER AUTHORITY.

(Oklahoma Furniture Mfg. Co., MC-C-2143, 4/22/59)

The Interstate Commerce Commission has decided that transportation services performed for a lessee of equipment by owner-operators of such equipment constitutes contract carriage for which a certificate is needed. Commissioner Webb, dissenting, called this decision "sweeping" enough to require certification of all truck-owner operators. It is understood that the case is being appealed.

The lessee and its drivers insisted, of course, that their relationship was one of employment. The Commission, however, found only three significant factors distinguishing the arrangement from the ordinary contract carriage situation: (1) separate tractor-leasing and driver-employment contracts were used; (2) the lessee absorbed the cost of liability and cargo insurance; and (3) the lessee exercised some employee controls over the owner-operators.

The Commission did not consider this sufficient. It reasoned that the two most significant instrumentalities of motor carriage - the equipment and the driver - were both furnished by the owner-operator. Even if the driver could be considered a bona fide employee with respect to his driver duties, he does not lose his independent-contractor's status with respect to his equipment. The Commission noted that "there is present, whenever the owner-operator drives his own equipment, the right and power of the lessor to defeat any supposed right to control that the shipper-lessee may believe exists." Moreover, it said that, as found in R.N.G. Commercial Auto Renters, Inc., 73 M.C.C. 665, many of the employee controls existing here were merely "natural concomitants of any contract-carrier operation devoted exclusively to the needs of a particular shipper." As for the shipper-lessee's assumption of insurance costs, this was "little more or less than a rate adjustment."

Commissioner Webb, in his dissent, noted that interspersed throughout the majority report are references to 15 indicia of private carriage, not one of which is present in the typical contract carriage operation. The manufacturer (1) pays the owner-operators for driving; (2) withholds social security and federal income taxes; (3) provides workmen's compensation benefits; (4) retains the right to hire and fire; (5) bargains with the owner-operators' labor union; (6) provides the trailer; (7) has exclusive control over all transportation equipment; (8) maintains such equipment; (9) assumes cargo-damage responsibility; (10) loads and dispatches the shipment; (11) issues detailed routing instructions; (12) issues no bills of lading; (13) keeps drivers' logs and medical certificates; (14) pays for liability and cargo insurance; and (15) expressly reserves the exclusive right to control and direct transportation service.

He said that the sweeping pronouncements of the majority report mean plainly and simply that, unless he holds a certificate, no owner-operator can be employed by a common carrier, a contract carrier, or by a private carrier if he rents and drives his own equipment.

BONA FIDE COOPERATIVE OF HOMEWORKERS EXEMPT FROM

FAIR LABOR STANDARDS ACT OF 1938.

(Mitchell v. Whitaker House Cooperative, Inc., 170 F. Supp 743, (1959)).

This was an action brought by the Secretary of Labor under the Fair Labor Standards Act of 1938, as amended, 29 U.S.C.A. § 201, et seq., to enjoin the Whitaker House Cooperative, Inc., and certain of its officers, (hereinafter called the Co-op) from violating the provisions of the Act. The court held, however, that the cooperative was bona fide organized and controlled by its members and the Act did not apply per se to the members of such a cooperative. He dismissed the complaint.

The complaint alleged that since July 18, 1957, the Co-op, organized under the Maine Consumers Cooperative Act, had violated the Act by paying wages to approximately 100 women homeworkers, who produced knitted and crocheted infants' outerwear sold by the co-op, at rates less than the minimum wage rates established by the Act; and by failing to keep proper records and to obtain special homework certificates with respect to such homeworkers as required by the regulations.

The issue for determination by the Court was whether the homeworker-members were "employees" of the co-op within the meaning of the Fair Labor Standards Act. The plaintiff contended that the homeworker-members are covered by the Act, on two grounds: (1) that the co-op is not a bona fide cooperative, and (2) that, even if the co-op were a bona fide cooperative controlled by its members, the Act applies to such member-controlled cooperatives. The defendants argued that the co-op is in fact a bona fide cooperative organized and controlled by its members and that the Act does not apply to the relationship between such a cooperative and its members.

The court said that a close examination of the history, corporate structure and present operation of the co-op, which is set out in some detail in the opinion, compelled the conclusion that it was a bona fide cooperative organized and controlled by its members for their mutual benefit and not merely a subterfuge created and utilized by the individual defendants for the purpose

of protecting Mrs. Whitaker's business operations from the application of the Fair Labor Standards Act. While it is true that the defendants actively participated in the organization of the co-op for the express purpose of attempting to avoid application of the Fair Labor Standards Act to the homeworkers activities, nevertheless, avoidance of a federal regulatory statute is not synonymous with its evasion. To organize Mrs. Whitaker's former homeworkers into a cooperative for the purpose of permitting them to continue to produce and sell their handiwork in a manner not within the reach of the law was not illegal or immoral. If, in fact, the Act does not apply to a true cooperative controlled by its members, these ladies had a right to organize and the individual defendants had a right to assist them in doing so.

Accordingly, the court concluded on the first issue that the co-op was properly organized and that the members were "not as a matter of economic fact working for the individual defendants." Hence, it became necessary to consider whether the Act applied to "member-controlled cooperatives per se."

He noted at the outset that a cooperative may be an employer and that this one in fact did employ certain persons subject to the Act. The substantial question, therefore, was "whether the producer-members of a marketing cooperative are its employees within the meaning of the Act." He reviewed the legislative history of the Act and concluded that there is no simple, uniform, and easily applicable test to determine whether persons doing work are covered; the test being whether as a matter of "economic reality" such persons are employees.

Here the evidence disclosed a marketing cooperative organized and operated by the ladies for the purpose of permitting them to sell to better advantage the products of their handicraft. The record showed also that the members were engaged, through the co-op in a joint venture for the production and sale of handknit infants' outerwear and that they were so engaged for their own mutual benefit, and not as employees employed by any one. Their interests as members and producers are identical. The work they performed was performed by them as members of the co-op and not as its employees.

In view of these circumstances, the court said, in conclusion:

"The 'economic reality' of the instant situation compels the conclusion that while these ladies work to produce their products, they do not work for the Cooperative, and neither does the Cooperative 'suffer or permit' them to work. It has no connection with their labors. Rather, they, collectively, 'suffer or permit' themselves individually to work. If the Fair Labor Standards Act be strained to recognize an employment relationship in these circumstances, such relationship can only be between these women as members and the same women as homeworkers. The Congress may wish in its legislative wisdom to declare that they so employ themselves. But in the opinion of this Court, the Act as written does not now so provide."

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DAIRY PRICE SUPPORT PAYMENTS UNDER REPURCHASE AGREEMENTS AGAIN HELD ILLEGAL

(Land O'Lakes Creameries, Inc., v. Commodity Credit Corporation, 8th Cir., 265 F. 2d 163 (1959)).

In this case the Eighth Circuit followed the Fourth Circuit in holding that payments made under the CCC price support program for dairy products, known as Department Announcement 112, were illegal because the transactions did not constitute either a "loan" or "purchase" within the meaning of the Agricultural Marketing Act of 1949, as amended. The earlier decision is Swift & Company v. United States, 4 Cir., 257 F. 2d 787 (1958).

Action was brought by Land O'Lakes Creameries, Inc., a cooperative association incorporated under the laws of Minnesota, engaged in the marketing of butter and cheese on behalf of its members, local farmers cooperatives, commonly described as a federated cooperative, against the CCC, a federal corporation created by Act of Congress as an agency and instrumentality of the United States within the Department of Agriculture. The action

was for a declaratory judgment to determine that certain payments made by CCC to the Cooperative in connection with its price support program of dairy products were valid. CCC by counterclaim sought recovery of the sum which it alleged had been illegally paid to the cooperative. In the district court judgment was entered for CCC for the principal sum without interest before the date of judgment. The cooperative appealed from the adverse judgment and CCC appealed from denial of such interest.

The Court of Appeals held that where payments were made to the co-op not on account of purchase of dairy products, but pursuant to a purported offer to purchase providing for a repurchase of the products by the creamery with a payment of not a purchase price but of an amount representing the difference between the support price and the price at which the co-op allegedly repurchased the products from CCC, with no delivery of the products to CCC,the transactions involved did not constitute a sale of dairy products nor their purchase by CCC and, therefore, such payments were not authorized by the Agricultural Act, and were illegally paid to the creamery.

The Agricultural Act of 1949, the court said, did not confer upon the Secretary of Agriculture discretion to support prices of dairy products in whatever manner he might think desirable, but specifically provided that the support be effected through the mechanism "of loans on or purchases of" dairy products. The court concluded for the reasons noted above that "the transactions here involved did not constitute a sale of Land O'Lakes dairy products or its purchase by the Commodity Credit Corporation."

The district court was also affirmed on the disallowance of interest prior to judgment, on the ground that this "was in conformity with equitable principles" where, as here, both parties entered into the transactions in good faith and neither party considered the payments illegal until a court had so held.